Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Federal-State Joint Board on Universal Service	CC Docket No. 96-45

To: Federal-State Joint Board on Universal Service

Comments of ACS of Alaska, Inc., ACS of Fairbanks, Inc., ACS of the Northland, Inc. and ACS of Anchorage, Inc. to the Federal-State Joint Board on Universal Service

Leonard A. Steinberg
General Counsel
ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
600 Telephone Avenue, MS 65
Anchorage, AK 99503
(907) 297-3000

Karen Brinkmann
Richard R. Cameron
LATHAM & WATKINS, LLP
555 Eleventh Street, N.W., Suite 1000
Washington, D.C. 20004
(202) 637-2200

Their Attorneys

September 30, 2005

TABLE OF CONTENTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Federal-State Joint Board on Universal Service	CC Docket No. 96-45

To: Federal-State Joint Board on Universal Service

Comments of ACS of Alaska, Inc., ACS of Fairbanks, Inc., ACS of the Northland, Inc. and ACS of Anchorage, Inc. to the Federal-State Joint Board on Universal Service

ACS of Alaska, Inc., ACS of Fairbanks, Inc., ACS of the Northland, Inc. (the "ACS Rural LECs") and ACS of Anchorage, Inc. ("ACS of Anchorage," together with the ACS Rural LECs, "ACS") hereby respond to the request of the Federal-State Joint Board on Universal Service (the "Joint Board") for comment on potential reforms to the rules of the Federal Communications Commission ("Commission") relating to distribution of high-cost universal service support.[1] ACS believes that the Joint Board should focus on ensuring that, as technology and market competition advances, all Americans continue to have access to affordable and reasonably comparable telecommunications and information services. To do so, ACS urges the Joint Board to recommend reforms that preserve and advance universal service, as required by the Telecommunications Act of 1996, and to reject reforms that would fracture today's uniform national policies or substantially reduce explicit support provided to rural carriers.

[1] Public Notice, "Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules relating to High-Cost Universal Service Support," CC Docket No. 96-45, FCC 05J-1 (rel. August 17, 2005) ("Notice").

I. Introduction and Summary

ACS is the leading integrated communications provider in Alaska, offering local telephone service, wireless, Internet, long distance and television to business and residential customers throughout Alaska. It was formed in 1999 through the acquisition of Anchorage Telephone Utility, a non-rural municipal telephone company serving the Anchorage market,[2] as well as three rural telephone companies formerly owned by Pacific Telecommunications, Inc.[3] ACS is the incumbent local exchange carrier ("ILEC") providing communications services to three-fourths of the state's population, serving 74 communities, including the population centers of Anchorage (ACS's only non-rural market), Fairbanks, Juneau, Kenai/Soldotna, Kodiak and Sitka. ACS also serves some of Alaska's smallest and most rural communities, with its smallest exchange serving just 17 customers. It is not uncommon for ACS's rural exchanges to be separated from each other by hundreds of miles, and, often, ACS's rural exchanges are accessible only by airplane or boat. While many of ACS's markets are characterized by high loop and switching costs, high transport costs between the local exchange area and other communities is also a significant issue for ACS.

ACS is deeply concerned about many of the ideas discussed in the Joint Board's Notice. It is the Joint Board's statutory mandate to recommend only those reforms that preserve and advance universal service in ways that are compatible with advancing technology and evolving market forces. The Notice, however, seeks comment on ideas that would represent giant steps backward in the Commission's ongoing effort to implement the universal service mandates of the 1996 Act. Specifically, the Joint Board should not recommend that the

---

2 Now known as ACS of Anchorage, Inc.

3 PTI Communications of Alaska, Inc. (which became ACS of Fairbanks, Inc.), Telephone Utilities of the Northland (ACS of the Northland, Inc.), and Telephone Utilities of Alaska (ACS of Alaska, Inc.).

Commission (1) consolidate rural carrier study areas for purposes of computing explicit universal service support levels; (2) base support for any rural carrier on the results of a cost model, whether based on embedded or forward-looking costs; or (3) compute universal service support levels for rural carriers differently based on the number of lines they serve. These proposals appear designed solely to reduce the size of the universal service funding mechanism, rather than to achieve any universal service goal. Each of the proposals would substantially curtail explicit universal service support rural carriers serving rural and high-cost communities, leaving these carriers without adequate means to maintain or improve their networks or provide high-quality service.

Far from reducing support for rural areas, the President, Congress, Chairman Martin, and the Commission have all made it a priority to expand access to advanced services, such as broadband, for all Americans. The Joint Board should assist this effort by proposing reforms that would ensure adequate explicit support for advanced services is available in high-cost and rural areas, where the costs of deployment often are otherwise prohibitive. To do so, the Joint Board should begin by recommending to the Commission that it (1) uncap rural carrier high-cost support to eliminate the penalties for efficiency created by the current cap; and (2) expand the scope of rural carrier support mechanisms to include transport costs that are not covered today.

ACS also opposes delegation to state public utility commissions of the responsibility to allocate support among ILECs within the state. State public utility commissions have an important role in assessing local conditions, for example in the context of enforcing service quality requirements and responding to consumer complaints. It is vitally important, however, that explicit universal service support be distributed in accordance with a consistent and uniform national policy developed by the Commission. If states were to take over the responsibility for determining the level of explicit support available to each carrier within the state, inconsistencies in the level of support available to similarly-situated carriers and even the types of services a carrier must provide in order to receive support would be inevitable.

II. The Joint Board Should Not Advocate Consolidating Rural Study Areas for Purposes of Computing Explicit Universal Service Support

All four of the proposals on which the Joint Board seeks comment would change the Commission's rules to compute support for rural carriers based on statewide average costs, either on a holding company basis or by averaging the costs of all carriers within the state.[4] The Joint Board sought comment on whether it should recommend such a change over one year ago,[5] and the fundamental legal and policy issues that ACS identified at that time remain unaddressed.[6]

A. Computing Universal Service Support based on Consolidated Rural Study Area Results Would Violate the Communications Act

Adoption of a state-wide or holding company standard for rural high-cost support eligibility would violate Section 254 of the Communications Act of 1934, as amended ("Communications Act") in several ways. *First*, Section 254(e) of the Communications Act requires the Commission to ensure that support is sufficient to keep rates affordable, while

---

4 Notice at 4 (Board Member Baum's proposal would use statewide average to allocate support among states), 8 (Proposal by Board Member Gregg to combine study areas for purposes of determining eligibility for universal service support), 17 (Proposal by Board Member Nelson to use statewide average costs), 24 (USERP proposal to provide "Part I" support only to states with high average costs, and limiting availability of "Part II" support to states where contributions to a state fund would be $2.00 per month per line).

5 Public Notice, "Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support," CC Docket No. 96-45, FCC 04J-2 (rel. Aug. 16, 2004), at 13 (¶ 41) ("*August 2004 Notice*").

6 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Comments of ACS (filed October 15, 2005), at 5-6.

converting support implicit in geographically averaged rates to explicit support.[7] The Commission has repeatedly identified rate averaging over large geographic areas as a chief source of implicit universal service support.[8] Geographic averaging of costs in computing support levels constitutes no less of an implicit subsidy. Indeed, recognizing this fact, the Commission has long pursued the goals of cost-based rates and disaggregation and targeting of support.[9] Reversing course now would reduce or eliminate explicit support for many rural carriers, particularly those that serve multiple study areas within a state. For example, outside of Anchorage, the remainder of Alaska is so sparsely populated, and costs of service are so high, that it would threaten high-cost loop support for every other study area in the state if support were calculated based on the combined cost characteristics of the entire state, or of every commonly-owned ACS study area. To the extent that market conditions would allow, carriers would be forced to fall back on implicit subsidies, in violation of Section 254(e). In Alaska, where the Commission has recognized the population center of Anchorage as one of the most competitive telecommunications markets in the country,[10] ACS has no ability to create implicit

---

7 47 U.S.C. § 254(e) ("[Universal service] support should be explicit and sufficient to achieve the purposes of this section.") (emphasis added); *Texas Office of Pub. Util. Counsel*, 183 F.3d 393, 425 (5th Cir. 1999) ("We are convinced that the plain language of § 254(e) does not permit the FCC to maintain *any* implicit subsidies for universal service support. Therefore, we will not afford the FCC any *Chevron* step-two deference in light of this unambiguous Congressional intent.")

8 *See, e.g., Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, FCC 97-157, 12 FCC Rcd 8776, 8784 (identifying statewide geographic rate averaging as a chief source of urban-to-rural implicit subsidy) (subsequent history omitted).

9 *See Federal-Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 96-45, Fourteenth Report and Order, 16 FCC Rcd 11244, 11299-11309 (¶ 136-164) (rel. May 23, 2001) (setting forth the Commission's findings with respect to disaggregation and the targeting of support) ("RTF Order").

10 *ATU Telecommunications Request for Waiver of Section 69.106(b) and 69.124(b)(1) of the Commission's Rules*, CPD 98-40, Order, FCC 00-379, 15 FCC Rcd 20655, 20670 (2000).

subsidies. If rural high-cost support were reduced as a result of study area consolidation, the ACS Rural LECs would be forced to raise rates for rural consumers, threatening affordability, a key tenet of universal service, within the state.[11]

ACS agrees with Board Member Gregg that study area consolidation would be particularly inappropriate in Alaska, where disparities in market, climactic, geographic, topographic, and demographic conditions are wider than nearly any other place in the country.[12] Anchorage is a non-rural, highly competitive, relatively densely populated telecommunications market of some 200,000 residents, and does not qualify for non-rural high-cost universal service support. In contrast, the remainder of the state is sparsely inhabited, frequently roadless, and often accessible only by boat or plane. The climate is severe. The terrain is rugged. The communities are small and often geographically separated by hundreds of miles, with high inter-office transport costs typically provisioned using satellite service. These unique characteristics would render meaningless the mathematical results of any geographical averaging of costs developed by consolidating study areas. Such figures simply would have no relationship to local costs, and thus would fail to produce support that would be "specific, predictable, and sufficient," as required by Section 254(b)(5).

Second, Section 254(b)(3) requires consumers in all areas of the nation to have access to telecommunications and information services that are reasonably comparable to those available in urban areas at rates that are reasonably comparable to those in urban areas. By reducing explicit support available to rural carriers, proposals to average costs (either on a statewide basis or on a holding company basis within the state) would violate this statutory

---

[11] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Prepared Testimony of Leonard A. Steinberg to the Joint Board (July 31, 2003), at 14-15 ("Steinberg Testimony").

[12] Notice at 9.

principle. Because competition in local markets now precludes reliance on implicit forms of support, reductions in explicit support would force carriers either to forgo investment in new or improved services in rural and high-cost portions of their service territories, or to seek rate increases to cover the higher costs of serving these customers. Either action would disserve the reasonable comparability principle of Section 254(b)(3). ACS, for example, faces significant competition in Anchorage, Fairbanks and Juneau, but especially in Anchorage, where GCI has captured roughly half of the market.[13] ACS of Anchorage could not retain its Anchorage customers if it implemented a rate increase sufficient to support rural areas served by the ACS Rural LECs. Therefore, ACS estimates that it would need to increase rates in its Sitka and Glacier State study areas *by over 200 percent* to account for lost support, reducing the comparability of its rate levels between urban and rural areas of the state. On the other hand, if the Commission were to adopt a state-wide or holding company eligibility criterion and thereby deprive rural communities of sufficient support, rural carriers would not be appropriately compensated for their specific costs of network maintenance and upgrades necessary to continue to provide the high quality services Congress intended for rural America. As a result, investment in the "provision, maintaining, and upgrading" of rural networks would suffer, reducing the comparability of urban and rural services.

Either way, the consumers who most depend on affordable telecommunications services would be harmed the most. It is fundamental business economics that network investment must be supported by an ongoing revenue stream that, for a rural LEC, comes from

---

13 As of June 30, 2005, ACS serves 88,000 lines in Anchorage. According to the Carrier and Specific Bulk Bill data which carriers submit to the Regulatory Commission of Alaska for intrastate access purposes, GCI serves roughly 89,000 lines in Anchorage. Comparable statistics for Fairbanks and Juneau are: ACS serves approximately 29,000 and 16,000 lines respectively, while GCI serves approximately 12,000 and 8,000 lines respectively.

retail charges or universal service support. ACS estimates that its Rural LECs could lose approximately $20 million in annual rural high-cost support if their eligibility for such support were based on the cost-per-line of all their affiliates statewide or at the holding company level.[14] If universal service support were thus curtailed, the shortfall in cost recovery, its revenue implications, and the decrease in the predictability of support, would impair not just ACS's ability to make new network investments, but also its ability to maintain its existing network, which is the only telecommunications network in much of the state.[15] Reductions in universal service support levels would further diminish ACS's ability to access capital markets.[16]

Finally, provisions in Board Member Baum's proposal to make state-by-state and carrier-by-carrier support determinations binding for up to five years would exacerbate, not cure, these statutory infirmities. By preventing support levels from responding dynamically to changes in costs, that proposal would reduce, not increase, the specificity, predictability, and sufficiency of support.

B. Computing Universal Service Support Based on Consolidated Rural Study Area Results Would Disserve the Public Interest

In addition to violating the Communications Act, proposals to aggregate costs at the statewide or holding company-wide level would disserve the public interest. Today, operating companies that consolidate under a single holding company structure can achieve

---

14 This figure represents ACS's aggregate potential loss of local switching support and high-cost loop support based on Universal Service Administrative Company quarterly forecasts. *See* http://www.universalservice.org/default.asp.

15 Steinberg Testimony at 8-9.

16 *See* Michael J. Balhoff, et al., *Reshaping Rural Telephone Markets*, Industry Analysis, Legg Mason Telecom, at 130 (Fall 2001) ("inequitable cost recovery systems necessarily affect the flow of capital and services. . . . Baldly stated, high-cost regions require high-cost support and/or higher rates; and if no financial relief is available, the result is likely to be subpar service or abandonment of rural regions") ("*Legg Mason Report*").

efficiencies in corporate operations expenses and overheads that stand-alone rural LECs are unlikely to match.[17] The Joint Board recognized this fact in the August 2004 Notice.[18] The August 2004 Notice fails to recognize, however, that these efficiencies result in lower per-line costs for carriers, and that these lower costs are reflected in rural carrier reporting, resulting in downward adjustments in per-line support. Therefore, cost savings from efficiencies attributable to economies of scale benefit consumers and decreases the demands on the universal service fund. In contrast, calculating support at the state or holding company level would encourage fractionalization of the industry, thwarting incentives to achieve such efficiencies. Holding companies would be forced to specialize either in urban or rural markets, or risk losing support for their rural exchanges. This specialization in serving either rural or non-rural areas would result, not because it would benefit consumers, improve service, or increase efficiency, but simply as a defensive response to artificial regulatory incentives. By breaking up holding companies that, like ACS, serve both rural and non-rural study areas, study area consolidation would actually *increase* demands on universal service support mechanisms because of lost efficiencies. Such a result clearly would disserve the public interest and result in a loss of economies of scale and upward pressure on the universal service fund.

Moreover, aggregating costs at the statewide or holding company level would arbitrarily penalize customers in high-cost areas that are served by carriers who happen to be affiliated with other carriers that serve low cost areas of the state, or that happen to live in a state

[17] Indeed, similar considerations have led the Commission to impose a cap limiting the amount of corporate operations expenses for which a carrier may seek support from federal universal service support mechanisms. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157, 16 FCC Rcd 11244, 11273-74 (2001) ("Rural Task Force Order").

[18] *August 2004 Notice* at ¶ 13.

with large numbers of low-cost lines. This change would therefore discriminate against individual rural *customers* based on whether their local telephone company is owned by a holding company that has affiliates serving non-rural areas. As explained by the U.S. Court of Appeals for the Fifth Circuit, "The [Communications] Act . . . promises universal service, and that is a goal that requires sufficient funding to *customers*, not *providers*."[19] The universal service support system has evolved so that providers act as surrogates for their customers and use universal service support to ensure high-quality affordable service to their customers. The ultimate beneficiary of universal support should be the rural consumer, and rural consumers should not be stripped of the benefits of high-cost support based merely on the corporate structure of their local exchange carrier.

III. Eligibility for Rural High-cost Support Should Continue to Be Based on the Communications Act's Definition of "Rural Telephone Company," Without Regard for the Number of Lines that Company Serves

ACS opposes Board Member Gregg's proposal to compute universal service support levels for any rural carriers serving over 100,000 lines within a state based on the holding company's statewide average costs, as determined by the Commission's forward-looking non-rural carrier high-cost model.[20] ACS believes that there is absolutely no legal mandate or policy justification for the Commission to differentiate among rural carriers in this way. The Communications Act identifies four independent and co-equal criteria that determine whether a carrier is a "rural telephone company."[21] The Commission has recognized that this definition identifies a particular class of carriers that, as a group, often face challenges in providing service

---

[19] *Alenco Communications, Inc. v. Federal Communications Commission*, 201 F.3d 608, 620 (5th Cir. 2000) (emphasis in original).

[20] Notice at 8.

[21] 47 U.S.C. § 153(37).

that are fundamentally different from those faced by non-rural carriers.[22] Whether a carrier, together with its affiliates, serves more or less than 100,000 lines within a particular state, however, is not among the criteria that Congress has prescribed, and the Notice offers no particular justification for its choice of this arbitrary, round number. Rather, this proposal would appear to do little more than reduce the total amount of support flowing to rural carriers in general, and the largest rural carriers specifically. To the extent that it does so, it suffers from the same legal and policy infirmities as the proposals to base support on statewide average costs, discussed above.

IV. ILEC Support Should Continue to Be Calculated Based on the ILEC's Actual Costs, Not the Results of a Cost Model

Three of the proposals on which the Joint Board seeks comment would base support for some or all rural carriers on the results of a cost model.[23] ACS emphatically urges the Joint Board to reject these proposals. ACS has gained extensive experience with the Commission's forward-looking cost model in protracted unbundled network element ("UNE") rate proceedings before the Regulatory Commission of Alaska ("RCA"). Based on this experience, ACS can confirm what Chairman Martin, the Commission, the Joint Board, and the Rural Task Force have already concluded: the Commission has no model that will produce

---

22 *E.g., Rural Task Force Order*, 16 FCC Rcd 11244, 11256 ¶ 25 (deferring transition to universal service support based on forward-looking cost model); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, FCC 97-157, 12 FCC Rcd 8776, 8936-45 ¶¶ 294-313. (1997) (*First Report and Order*) (subsequent history omitted) (same).

23 Notice at 4 (Proposal by Board Member Baum to incorporate embedded cost model into the SAM), 8 (Proposal by Board Member Gregg to compute support for largest rural carriers using the non-rural, forward-looking model), 15 (Proposal by Board Member Nelson to incorporate the SAM).

accurate or even predictable cost estimates for rural carriers.[24] Indeed, in 2000, under the auspices of the Joint Board, the Rural Task Force, composed of a diverse cross section of industry and regulatory representatives, concluded that, when applied to 23 rural test carriers, the Commission's model used in computing explicit high-cost support for non-rural carriers suffered from seven specific and critical failings, namely that:

- "The model lines differed significantly from actual lines served. While the model generally tended to underestimate lines, in about one-third of the wire centers it overestimated lines.

- "Comparisons of the number of route-miles of plant summarized in the model with actual data produced significant variations. Again, differences occurred on both the high and low ends with a general tendency for the model results to overestimate the actual data. In 12 percent of the wire centers studied, the model overestimated route miles by more than 200 percent.

---

[24] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Notice of Proposed Rulemaking, FCC 03-224, 18 FCC Rcd 18945, Statement of Commissioner Kevin J. Martin ("[T]he existing TELRIC formula may provide incumbent service providers with an insufficient return on investment capital for new infrastructure") ("*TELRIC NPRM*"); *Rural Task Force Order,* 16 FCC Rcd 11244, 11256 ¶ 25 ("The present record fails to provide the analysis necessary to permit a transition of rural carriers to a forward-looking high-cost support mechanism."); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, FCC 00J-4 (rel. Dec. 22, 2000) ("*Joint Board RTF Recommended Decision*") ("The Rural Task Force has proceeded with caution by proposing modifications to the current embedded cost system for a five-year period, rather than attempting to modify the Commission's forward-looking cost mechanism that currently is used to determine non-rural support. We agree with the Rural Task Force that understanding the diversity among rural carriers and the differences between small rural carriers and large carriers is desirable in designing appropriate universal service support mechanisms . . . Specifically, the Rural Task Force demonstrated the inappropriateness of using input values designed for non-rural carriers to determine support for rural carriers."); *Joint Board RTF Recommended Decision*, Appendix A, "Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service" ("*RTF Recommendation*"), at 18 ("The aggregate results of this study suggest that, when viewed on an individual rural wire center or individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers.") (available at http://www.wutc.wa.gov/rtf/rtfpub.nsf?open).

- "Model results for the type of plant varied widely from actual plant constructed. The model generally tended to overestimate the percentage of aerial and underground plant, and underestimated the percentage of buried plant. This was likely due to the diverse character of the rural geography, and the use of a single set of inputs by density zone that was based on the experience of non-Rural Carriers.

- "In calculating the applicable density zones, the model significantly underestimated wire center area. In 95 percent of wire centers the land area was understated, and in over one third of these the understatement exceeded 90 percent.

- "The Synthesis Model significantly underestimated central office equipment (COE) Switching investment. This was likely due to the lack of economies of scale of the Rural Carriers, and the general tendency of the model to underestimate lines served.

- "The Synthesis Model results for various elements of general support investment varied widely from actual data and from rational forward-looking assumptions, with almost as many cases of overestimation as underestimation.

- "Network Operations and Customer Operations expenses were significantly underestimated. This was likely related to the lack of economies of scale of Rural Carriers."[25]

Since the Rural Task Force completed this analysis, no changes to the model have been made that would remedy these failings.

While Board Member Baum acknowledges the lack of reliability in the Commission's model, he asserts that, if applied on a statewide basis, errors will tend to "cancel out."[26] This analysis ignores at least two critical facts. *First*, as reflected in the list above, when applied to rural carrier service territories, the model does *not* tend to make random errors that would cancel one another out but, rather, makes errors that consistently understate line counts, central office equipment, wire center area, more expensive buried plant, network operations and

---

[25] *RTF Recommendation* at 17-18. The Rural Task Force also noted that the non-rural model does not currently contain customer location and other data to produce results for rural wire centers in Alaska and the insular areas. *Id.*

[26] Notice at 4.

customer operations expenses, and overestimate total route miles of plant, as well as less expensive aerial plant. Such an array of systematic errors, which create a consistent bias in favor of sharply understating rural carrier costs, simply will not "cancel out" to produce an accurate result.

Second, no matter what model is used and whether it is based on forward-looking or embedded costs, the results will vary widely based on the input values chosen. In Alaska UNE proceedings, in which the RCA used the Commission's forward-looking, "TELRIC" cost model to set rates, facially credible testimony from opposing witnesses supported the use of inputs that produced loop costs ranging from roughly $5.00 to $25.00. Regulators are not well positioned to make such determinations in the first place and, with the state's eligibility for federal universal service support hanging in the balance, the issue is likely to be at least as contentious as it is in UNE rate proceedings that, even today, provoke ceaseless litigation that consumes untold carrier and regulatory resources.[27] Indeed, the RCA's determination of Anchorage UNE loop rates, after four and half years of arbitration, is now being challenged in federal district court in Anchorage, Alaska. If state commissions were charged with the responsibility for determining state-specific inputs for high-cost support, the results across the country could not be compared to one another in any meaningful way.[28]

The difficulties with model-based support, as applied to rural areas, are not limited to errors in the model's calculations or inputs, however. Even if the Commission were

---

[27] *TELRIC NPRM*, 18 FCC Rcd 18945, 18948-49 ¶ 6.

[28] To the extent that the change to model based support is intended to reduce rural carrier support levels, ACS cautions that there is no guarantee that forward-looking costs in rural exchanges will be lower than the carrier's actual costs. It is impossible to determine at this stage that the forward-looking cost of building and maintaining a network and providing service in rural Alaska, including today's cost of labor, capital, and equipment, would be lower than embedded costs.

somehow to develop an error-free model, it should still decline to use it to determine rural carrier support levels, because rural network investment and service quality suffer when the link between cost recovery and a carrier's actual underlying costs is severed. This is true whether the cost recovery at issue is from explicit universal service support mechanisms or retail rates, and the Commission's experience with price cap regulation effectively illustrates the point. Because it divorces cost recovery from a carrier's underlying costs, price cap regulation simply did not effectively aligning the interests of carriers that served large geographic areas having diverse cost characteristics with the interests of their rural customers. When the Commission adopted price cap regulation, one stated goal was to create a system that would "avoid the perverse incentives of rate-of-return regulation" for carriers to "gold-plate" their networks.[29] Experience shows, however, that price cap regulation systematically discouraged large carriers from investing adequately in the highest-cost parts of their study areas. Thus, the implementation of price caps caused carriers to allow those high-cost exchanges to deteriorate. Indeed, by 2000, after ten years of price cap regulation, investment in rural areas served by price cap carriers had dropped sharply, and customer complaints had increased dramatically in these areas.[30] Under

---

29 *See CALLS Order*, 15 FCC Rcd at 12968, ¶ 14; *LEC Price Cap Order*, 5 FCC Rcd at 6790, ¶ 29 ("Our own experience with administering a rate of return system convinces us that carriers in fact attribute unnecessary costs to their operations in an effort to generate more revenue.").

30 *See Access Charge Reform*, CC Docket No. 96-262, Comments of CenturyTel, Inc. (filed Jan. 22, 2002) at 2-3 ("[h]aving purchased the majority of its rural exchange lines from price cap carriers, CenturyTel has observed that rural exchanges divested from the larger companies often are in areas where the sellers have invested the least" and "divested loops in many areas [are] fully exhausted" such that they require the purchaser to "reinforce the loop, install new fiber, and drop in remote terminals" before the customers can receive basic services required under universal service obligations.); Iowa Telecommunications Services, Inc., Emergency Petition for Forbearance (filed Nov. 26, 2001) (noting that divested rural exchanges often require substantial upgrades); *Legg Mason Report* at 21 (observing that "[r]ural line consolidators have reported regularly that the plant acquired from the [BOCs] requires significant repair to meet minimum service standards," and that "[v]arious state

rate-of-return regulation, carriers invest in plant and equipment routinely to maintain or improve service quality, launch additional services in order to grow revenue, comply with state service quality requirements, and maintain their business reputation. In rural areas outside their strategic core markets, faced with the Commission's declining (and capped) rates, and higher-than-average costs, the largest price cap carriers were largely unwilling to make this commitment.[31] The result was that these carriers often neglected their most rural exchanges, determining instead to cut costs in those exchanges to the bare minimum and divest them whenever possible.[32]

If the Joint Board ultimately decides to recommend use of a cost model, ACS wholeheartedly agrees with Board Members Baum and Gregg that Alaska should be exempted from this requirement. In Alaska, the RCA has set a forward-looking UNE loop rate of $18.64 per month in Anchorage. This rate bears little resemblance to ACS of Anchorage's true costs of approximately $25.00 per month.[33] Despite the RCA's use of the model to set UNE loop rates in the state's population centers, the Commission's universal service model is ill-equipped to properly take into account Alaska's unique cost characteristics statewide.

---

public service commissions (e.g. Minnesota, Arizona, California and Oregon) . . . have refused to permits sales [of the BOCs exchanges] until certain minimum standards were met by the selling [BOC]."); *Quality of Service of the Local Operating Companies,* Federal Communications Commission, Common Carrier Bureau, Industry Analysis Division (Dec. 2001), at 7 and Chart 3 (showing the continued high level of customer dissatisfaction with ILEC service and noting the "sharp increase in customer complaints observed in the SBC Ameritech Region").

31 *See e.g.*, *Legg Mason Report* at 20-21 (concluding after analyzing numerous ARMIS reports that in recent years "RBOC managements have directed resources to urban areas, where long-term strategic positioning is key and higher return on investment can be generated. As a result, it appears that rural investments have been minimal and, when the companies are pressed to upgrade non-urban properties, divestitures become a more logical outcome.")

32 *Id.* at 156 ("[V]irtually every acquirer of RBOC lines has reported difficulties with cabling and serving electronics. VALOR reported that it was required to completely reinstall its outside plant in one region, where there was extensive use of lead cable.").

33 ACS Expert Testimony supported a rate of approximately $25.00 per month.

V. The Joint Board Should Seek Ways to Advance the President's National Broadband Policy

The President, Congress, Chairman Martin, and the Commission have all made it a priority to expand access to advanced services, such as broadband, for all Americans. The President has set a national goal to have "universal, affordable access for broadband technology by the year 2007, and then we ought to make sure as soon as possible thereafter, consumers have got plenty of choices when it comes to [their] broadband carrier."[34] Congress is also focused on ensuring universal access to affordable broadband. For example, legislation introduced July 20, 2005, would create a $500 million fund to support broadband deployment in rural areas,[35] and more efforts are underway.[36] The Congressional Research Service recently released its analysis of "universal service in a broadband environment," discussing the major issues legislators and policymakers will need to consider in funding broadband deployment.[37] Furthermore, Chairman Martin has declared "promoting new packetized networks throughout the nation" to be one of the FCC's "core priorities" along with stimulating "investment and the deployment of new packetized networks and facilities that will bring new broadband services to all Americans

---

34 President George W. Bush, March 26, 2004 (*quoted in* "A New Generation of American Innovation," (The White House, April 2004), at 11 (available at: http://www.whitehouse.gov/infocus/technology/economic_policy200404/innovation.pdf)).

35 S. 1583, 109th Cong., 1st Sess. (2005) ("Universal Service for the 21st Century Act," introduced by Senators Dorgan and Smith).

36 For example, various news reports indicate that Senators Stevens and Burns currently intend to propose legislation in this area. *See, e.g.*, Anne Veigle, *Burns USF Bill to Focus on Contributions and Fund Spending*, COMM. DAILY, Aug. 16, 2005, at 1 (discussing legislation being drafted by Senators Stevens, Burns, Rockefeller, and Snowe).

37 Charles B. Goldfarb, *Telecommunications Act: Competition, Innovation, and Reform*, CRS Report for Congress (rel. August 12, 2005), at 57-61.

throughout the nation."[38] Finally, just this summer, the Commission released a draft of its Strategic Plan for 2006-2011, which enunciates the Commission's goal that "[a]ll Americans should have *affordable* access to robust and reliable broadband products and services"[39] and cites economic considerations, such as price and deployment costs, as a key factor in affecting achievement of that goal.[40]

Despite this national policy focus, the Notice dwells on a host of cramped proposals, such as those discussed above, to consolidate rural carrier study areas, change eligibility for rural carrier support, and switch to a cost model, that collectively would sharply reduce the amount of explicit support available to rural carriers. Such "reforms" would be counterproductive at best to the achievement of the nation's broadband policy goals. The Join Board should instead adopt reforms that advance national broadband deployment and anticipate the rapidly approaching time (if indeed it has not already arrived) when broadband should be included in the Commission's definition of universal service.[41]

The Joint Board should assist this effort by proposing reforms that would ensure adequate explicit support for advanced services is available in high-cost and rural areas, where the costs of deployment often are otherwise prohibitive. To do so, the Joint Board should begin

---

[38] *Petition of SBC Communications Inc. for Forbearance from the Application of Title II Common Carrier Regulation to IP Platform Services*, WC Docket No. 04-29, Memorandum Opinion and Order, FCC 05-95 (rel. May 5, 2005) (statement of Kevin J. Martin, Chairman).

[39] Public Notice, "Public Invited to Review Draft Strategic Plan" (rel. July 5 ,2005), at 6 (emphasis added).

[40] *Id.* at 7.

[41] In establishing the definition of universal service, Section 254(c)(1) requires the Commission to consider the extent to which a service (A) is essential to education, public health, and public safety; (B) has, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers; (C) is being deployed in public telecommunications networks by telecommunications carriers; and (D) is consistent with the public interest, convenience, and necessity. Broadband service meets or is well on the way to meeting each of these criteria today.

by recommending to the Commission that it (1) uncap rural carrier high-cost support to eliminate the efficiency penalties created by the current cap; and (2) expand the scope of rural carrier support mechanisms to include transport costs that are not covered today.

A. ACS Supports Uncapping Rural Carrier High-Cost Loop Support

Deployment of broadband in rural areas is costly, requiring, at a minimum, substantial plant upgrades such as loop conditioning and new central office equipment. In many cases, deployment in remote areas requires much more, including fundamental plant reengineering to shorten loop lengths, deployment of new technologies, such as DSL-compatible digital loop carrier systems. Yet, the Commission's cap on rural carrier high-cost loop support is causing support to rural ILECs to shrink, for two reasons. *First*, the Commission limits growth in the overall fund with the "Rural Growth Factor," which is the sum of the percentage change in rural ILEC lines and inflation.[42] For 2005, the Rural Growth Factor is negative, causing total high-cost loop support for rural ILECs to shrink.[43] At a time when national policy leaders are calling for massive new investment to support universal broadband availability in rural America, the Commission's rules are creating real year-over-year reductions in the limited support rural carriers have available to fund these upgrades.

Second, the high-cost loop support fund, already capped at a level substantially below that required to meet actual demand, is distributed only to those carriers with the highest costs.[44] Thus, the cap creates a classic prisoner's dilemma for rural ILECs. While rural carriers as a group would fare better if they focused exclusively on operating efficiently, the cap

---

[42] 47 C.F.R. § 36.604.

[43] Universal Service Administrative Company, Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2005 (filed Aug. 2, 2005) at 7 (rural growth factor for 2005 is -0.04 percent).

[44] 47 C.F.R. § 36.622(c)(2).

establishes incentives for each rural carrier, if it is able to do so consistent with market conditions, to ensure that its costs increase at least as fast as the national average, lest it lose support relative to other rural carriers. These incentives penalize carriers that strive for efficiency and harm rural carriers as a whole by increasing strain on the support mechanisms.

The ACS Rural LECs lose twice – first because they receive support that is capped at a level below what the Commission's mechanism otherwise would produce, and second because competition in Alaska creates market discipline that forces ACS to operate efficiently, despite incentives to the contrary that other rural carriers are able to exploit. If the Commission were to lift the cap on the high-cost support mechanism, all rural carriers could focus instead on making sound investments in maintaining and improving service to their customers, and the Commission would see sound carrier investment decision-making that would reflect the knowledge that sufficient support that does not fluctuate based on the actions of other carriers will be available to support reasonable and prudent investments.

B. ACS Supports Expanding the Definition of Covered Costs

Board Member Gregg also wisely proposes to expand universal service support for rural carriers to include interoffice transport and other non-loop investment, and ACS encourages the Joint Board to incorporate this proposal in its recommendations.[45] For years, support for non-rural carriers has included support for interoffice transport costs, as the Commission's cost model purports to take into account all of a carrier's costs of providing the services within the definition of universal service. For rural carriers, as the Notice recognizes, while support has been available for loop and switching investment, no such support has been

45 Notice at 10.

available for interoffice transport.[46] Carriers unquestionably incur transport costs in providing the universal service package, however, and explicit Commission mechanisms should be available to support carriers whose transport costs exceed levels that would permit them to maintain affordable and reasonably comparable rates. For example, in Alaska, to bring the benefits of SS-7 signaling capability to many isolated rural communities, ACS must purchase costly transport services to interconnect switches in these remote communities with the SS-7 network at distant Signal Transfer Points. Often no terrestrial interoffice transport facilities exist to connect these remote locations to the rest of the network. In those circumstances, ACS must purchase satellite-based transport links, at considerably higher cost, yet there is no federal support for them in today's high-cost funding mechanism.[47]

In addition, as penetration of broadband services increases, carrier interoffice transport costs will necessarily increase. Particularly in Alaska where, as explained above, transport to rural areas often must be provisioned using satellite facilities, the transport costs alone can make rural broadband access prohibitively expensive. ACS estimates that the costs of the additional transport capacity alone that would be required to bring even low-end (*e.g.*, 300 Kbps) broadband Internet access to remote Alaskan locations could exceed $100 *per customer per month*. Consistent with the national broadband policy goals discussed above, therefore, the Joint Board should recommend, and the Commission should adopt, rules to support these increased non-loop costs.

---

[46] *Id.*

[47] For example, ACS's monthly cost per DS-1 for a 260-mile terrestrial fiber link between Fairbanks and Valdez, is roughly $3000.00. For a similar length of haul on a route where terrestrial fiber is unavailable, such as between Anchorage and Kodiak, ACS's cost is roughly four times as great. Satellite-based transport on that route costs ACS roughly $12,000 monthly per DS-1.

VI. The Responsibility of the States Should Continue to be Assessing Local Conditions, such as Adequacy of Service, and Affordability and Reasonable Comparability of Rates

All four of the proposals before the Joint Board would fundamentally change and expand the role state public utility commissions play in determining the distribution of federal universal service support.[48] ACS opposes these efforts to arrogate this responsibility to state commissions. The current, cost-based system is effectively administered by USAC, and ACS believes that a single administrator, operating under rules established by the Commission, is the only way to ensure that universal service support continues to be distributed according to a uniform set of national policies and procedures. The current system ensures consistent national policy (uniformly applied among carriers) on reimbursement of ILEC costs to ensure comparable services nationwide. In contrast, if support distribution policy devolves to the state level, the result will be inconsistency in the services supported, the levels of support, and ultimately the services available to consumers. Similarly situated carriers with similar cost characteristics could end up receiving wildly divergent levels of federal support, simply by accident of geography. In addition, by continuing to administer support distribution at the national level, the Commission will ensure that future changes in policy (such as changes in the definition of covered services, changes in the expenditures that are reimbursed, or changes in methodology for accounting and reporting) will be uniformly administered across all carriers in all states, and implemented at a uniform time for all carriers. Similarly, while proposals to establish a separate

---

[48] Notice at 3-4 (Board Member Baum proposal for state allocation of federally-determined block of universal service support), 12 (Stage Three of Board Member Gregg's proposal adopting mechanism similar to Board Member Baum's), 14 (Board Member Nelson proposal discussing block grants and state allocation mechanism), 20 (USERP proposal incorporating state allocation mechanism).

support fund for wireless CETCs may deserve further study, the states should not have discretion over how to allocate the funding among CETCs.

This is not to say that state commissions lack an important, even vital role. State commissions should continue to fulfill their historical role in overseeing local rates for regulated monopolies and verifying compliance by all ETCs with national standards, based on local conditions. State commissions historically also have played a critical role in administering intrastate universal service mechanisms, which are an important complement to federal mechanisms. In addition, subject to clear national rules established by the Commission, state commissions also could have an important role to play if the Commission decides to establish an affordability benchmark. Such a benchmark should not be calculated at the national level, but must reflect local conditions, such as household income, cost of living, demographics, and other parochial factors. The Commission should develop a weighted formula based on these local factors that state commissions, with their detailed knowledge of local conditions, could implement to determine affordability at the local level. In this respect, Board Member Baum's proposal in on the right track in proposing that a benchmark should take into account various local factors and recognizing that "[a]ffordability varies across [s]tates based on economic and demographic factors."[49] This proposal, however, should be further refined to include additional factors, and should consist of a formula that could be mathematically applied with minimal discretion by state commissions. Moreover, state commissions should monitor service penetration rates as a bellwether for determining whether rates are unaffordable. Finally, state commissions should continue to take a central role in evaluating the performance of ETCs that receive support, to ensure that they use the support for the intended purposes, fulfill any build-

[49] Notice at 5.

out commitments, provide service at rates that are deemed affordable, and provide a level of service that is comparable to that of the ILEC.[50]

[50] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, FCC 05-46, 20 FCC Rcd 6371 ¶¶ 58-64 ("*CETC Order*"). In the *CETC Order*, the Commission also discussed its own authority to ensure that state commission standards are adequately rigorous. *CETC Order* at ¶ 63 ("We also note that the Commission may institute an inquiry on its own motion to ensure that high-cost support is used 'only for the provision, maintenance, and upgrading of facilities and services' for the areas in which ETCs are designated . . . . [T]he Commission will continue to monitor use of universal service funds by ETCs and develop rules as necessary to continue to ensure that funds are used in a manner consistent with section 254 of the Act.") (*citing* 47 U.S.C. § 254(e)).

VII. CONCLUSION

For the forgoing reasons, in order to preserve and advance universal service in Alaska, the Joint Board should (1) not advocate consolidation of rural carrier study areas to compute explicit universal service support based on statewide or holding company-wide average costs; (2) recommend retention of the current criteria for determining whether a carrier is eligible for rural universal service high-cost support; (3) oppose use of a cost model in computing rural carrier support; (4) advance national broadband policy by uncapping rural high-cost loop support and creating additional support for transport costs; and (5) recommend regulatory structures that ensure universal service support continues to be distributed based on uniform national policies that take into account affordability at the local level and hold all ETCs accountable for compliance with federal requirements.

Respectfully Submitted,

ACS OF ALASKA, INC., ACS OF FAIRBANKS, INC., ACS OF THE NORTHLAND, INC. AND ACS OF ANCHORAGE, INC.

/s/ *Richard R. Cameron*

Karen Brinkmann
Richard R. Cameron
LATHAM & WATKINS, LLP
555 Eleventh Street, N.W., Suite 1000
Washington, D.C. 20004
(202) 637-2200

Their Attorneys

Leonard A. Steinberg
General Counsel
ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
600 Telephone Avenue, MS 65
Anchorage, AK 99503
(907) 297-3000

Dated: September 30, 2005